

**TO: THE CHIEF EXECUTIVE OR MANAGING OFFICER OF ALL
LOUISIANA STATE-CHARTERED BANKS AND THRIFTS**

FROM: SID SEYMOUR, CHIEF EXAMINER

DATE: MAY 16, 2007

RE: LOUISIANA OFFICE OF FINANCIAL INSTITUTIONS (OFI) UPDATE

Overall Financial Condition – A vast majority of the banks and thrifts domiciled in the State of Louisiana remain in sound financial condition. As of December 31, 2006, there were 166 banks and thrifts domiciled in the state, with 134 or approximately 81% being state-chartered. If you have not already done so, please take time to visit our website at www.ofi.louisiana.gov, click either the bank or thrift link, and then click OFI Financial Reports - December 31, 2006, for a thorough and comprehensive historical compilation of banking and thrift trends in the State of Louisiana. These reports are prepared on a semi-annual basis and contain key financial ratios, CAMELS ratings, CRA ratings, and a brief overview of the state's economy. The current edition also contains an update on the banks and thrifts that were affected by Hurricanes Katrina and Rita. Please let me know if you have any comments or questions regarding the contents of this edition. I would also be interested in hearing any meaningful suggestions of what you would like to see in future editions.

Preparations for the Upcoming Hurricane Season – In OFI Bulletin **BL-02b-2006 (B,T)**, dated June 21, 2006, we requested and have compiled primary and secondary emergency contact information for your disaster recovery team that will only be used in the event that we have to deal with another wide-area disaster. The disaster recovery team is expected to maintain emergency contact information for the board and senior management. Please notify this office immediately if your disaster recovery team information has changed from last year. If you have any changes or questions, please contact Executive Staff Officer Donna Montagnino at (225) 922-2627 or by email at dmontagnino@ofi.louisiana.gov.

As mentioned previously, OFI has been assigned to several emergency support functions within the Governor's Office of Homeland Security and Emergency Preparedness (GOHSEP). In the event that we have to deal with another wide-area disaster, we will receive information through the GOHSEP. This information will then be shared with the industry through frequent conference calls, emails, and postings to our website. Similar to 2006, this Office will participate in another series of Hurricane Preparation Meetings, hosted by the Louisiana Bankers Association (LBA), as detailed below. We would urge each institution to send a representative of their disaster recovery team to one of these meetings.

1. Thursday May 31, 10:00 a.m., IBERIABANK, 200 West Congress Street, 12th floor, Lafayette
2. Friday June 1, 10:00 a.m., Parish National Bank, 404 East Kirkland Street, Covington
3. Tuesday June 5, 10:00 a.m., Cameron State Bank, 4440 Nelson Road, Lake Charles
4. Wednesday June 6, 10:00 a.m., Gulf Coast Bank, 848 Harrison Avenue, New Orleans
5. Friday June 8, 10:00 a.m., South Louisiana Bank, 1362 West Tunnel Blvd, Houma

Please contact me directly at 225/925-4675 or by email at sseymour@ofi.louisiana.gov with any questions.

2007 Legislative Fiscal Session – While OFI is tracking a number of House and Senate Bills introduced in the current Legislative Fiscal Session that may have a direct or indirect impact on your industries, our legislative package included only three bills. One bill in particular, HB 314 that was introduced by Representative Bruce, establishes an online database for our Residential Mortgage Lending Program that will greatly assist state agencies nationwide in detecting and preventing mortgage loan fraud. If you want more information about this online database, please contact Deputy Chief Examiner Darin Domingue at 225/922-2596 or by email at ddomingue@ofi.louisiana.gov. The remaining two bills are intended to address specific housekeeping issues. We are in support of SB 253, introduced by Senator Hollis and sponsored by the LBA, which pertains to financing single premium insurance in connection with residential mortgage loans. Eventually, the enrolled bills will be available on the Legislature's website at: www.legis.louisiana.gov. Please contact General Counsel Sue Rouprich at 225/922-1028 or by email at srouprich@ofi.louisiana.gov with any questions.

Review of the ALLL Account – In January 2007, OFI Staff CPA Mrs. Dale Jacobs, along with Candy Wright and Bill Balhoff with Postlewaite & Netterville, CPAs, and FDIC Regional Accountants Robert Warren and Danita Sprague, presented a series of three training sessions for industry personnel sponsored by the Louisiana Bankers Association (LBA). The training provided a thorough review of the applicable accounting principles and regulatory requirements that must be considered in determining the adequacy of the Allowance for Loan and Lease Losses (ALLL) account. We noted that 96 institutions sent at least one representative these training sessions. Again, we share your desire for a strong ALLL account and hope that these training sessions assisted you in understanding ways in which you can maintain strong reserves while still complying with Financial Accounting Standards Board (FASB) requirements. Please contact Staff CPA Mrs. Dale Jacobs at 225/922-0632 or by email at djacobs@ofi.louisiana.gov with any questions.

Concentrations in Commercial Real Estate (CRE) Lending – On December 12, 2006, the federal banking agencies (FBAs) issued guidance reminding institutions of the substantial risks associated with CRE lending concentrations and the need to have enhanced risk management practices and procedures in place to deal with the high degree of risk inherent in such portfolios. Beginning with the March 31, 2007, Call Report, institutions meeting certain criteria were required to provide more information on their CRE lending portfolios. Institutions should perform their own assessment of concentration risk in their CRE lending portfolios. Institutions that exceed certain CRE concentration thresholds, as detailed in the guidance, are expected to have more sophisticated risk management practices, procedures, and processes in place in order to properly monitor such risk on an ongoing basis. Examiners will be reviewing for such concentrations at future examinations and through the off-site monitoring process. If you have not already done so, please be sure to become familiar with the guidance that can be located at <http://www.fdic.gov/news/news/financial/2006/fi06104.html>. Please contact me directly with any questions.

Fair Lending Reviews – In 2005, the FBAs began using home loan price data obtained under the Home Mortgage Disclosure Act (HMDA) as a screening tool to identify aspects of the higher priced mortgage market that warrant a closer review. You can expect the FBAs to conduct a

closer review for compliance with HMDA if the statistical data indicates that a financial institution's interest or denial rates differ substantially depending on an applicant's race or gender. These reviews, while done as unobtrusively as possible, can be very time consuming to the management of an institution. Whenever a FBA conducts a closer review for compliance with HMDA, OFI will participate in order to be fully-informed of what is reviewed, discussed, and discovered during the course of these reviews. Here are several suggestions that may be useful in preparing for such reviews:

- (1) Be sure that you are reporting correctly—garbage in, garbage out. Take extra care when reporting the HMDA data, as incorrect reporting may cause outliers that may be costly and time consuming to explain. It may be beneficial for an independent person to double check the initial report before it is finalized
- (2) Track discrepancies and be aware of them before they persist. I understand that there are computer programs that will warn management of loans made outside of the parameters set in the program. With this information, management can identify outliers and ensure that they are properly documented before a long-term pattern is established. As with any MIS data, management must make a point of reviewing the data to ensure that all outliers are appropriate and well documented.
- (3) Document, document, document. A banker may deviate from the standard rate sheet when assigning an interest rate to a mortgage loan for reasons such as the borrower's credit history, loan-to-property value ratio, consumer debt-to-income ratio, competitive factors, or compensating balances; however, acceptable reasons for deviations should be established in written policies and procedures. When a mortgage loan is assigned an interest rate different from the standard rate sheet, the reasons must be properly documented and supported. Unsupported reasons for an exception to the rate sheet will result in further effort and time on behalf of the examining team as well as that of the bank.

Please contact Deputy Chief Examiner Kerry Morris at 225/925-4201 or by email at kmorris@ofi.louisiana.gov with any questions.

Early Adoption of FAS 157 and 159 Fair Value Accounting – Nationwide, we understand that a number of institutions have “early” adopted Statement of Financial Accounting Standards No. 157 (FAS 157), *Fair Value Measurements* and FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, after consultation with investment brokers and CPAs. A majority of these institutions have re-classified lower-yielding investments from a held to maturity (HTM) or available for sale (AFS) classification to the fair value option offered under FAS 159, which enabled unrealized gains or losses on these securities to bypass earnings and go straight to retained earnings on January 1, 2007. Subsequent to the reclassifications, many institutions sold their lower-yielding securities and replaced them with higher yielding securities and classified them as HTM or AFS securities on a “go-forward” basis. Since many institutions appeared to be adopting FAS 157 and FAS 159 for the purpose of replacing lower-yielding investments with higher yielding investments without classifying the replacements under the fair value option offered under FAS 159, questions were raised to the staff of the Securities and Exchange Commission concerning whether these investment strategies were consistent with the principles and objectives of FAS 159. As a result of these questions and the discussions that followed, on April 17, 2007, the Center for Audit Quality (CAQ), which is affiliated with the American Institute of Certified Public Accountants, issued an audit alert (CAQ Alert) to auditors

concerning questionable practices associated with the early adoption of FAS 159. The CAQ Alert may be accessed at the following web address:

http://www.aicpa.org/caq/download/CAQAlert2007_14_04172007.pdf.

The CAQ Alert discusses how an auditor should consider the investment strategies outlined above from an accounting standpoint and the conclusion an auditor should reach concerning their propriety under FAS 159. The CAQ Alert states the following concerning early adoption of FAS 159: “FAS 159 clearly articulates the principles and objectives of the standard. Principles-based standards should be applied in a good faith manner consistent with those objectives and principles. Although FAS 159 allows for early adoption . . . , auditors should exercise appropriate professional skepticism and be alert for circumstances in which an entity proposes to adopt FAS 159 in a manner that is contrary to the principles and objectives outlined in the standard.”

“For example, assume an entity purports to adopt FAS 159 by electing the fair value option for certain eligible underwater available-for-sale and held to maturity investment securities, and certain financial liabilities. Shortly thereafter, the entity disposes of those investment securities and settles those liabilities. The entity does not elect the fair value option for newly purchased investment securities and newly issued liability instruments. The totality of these actions appears to indicate that the entity has little or no intent to utilize the fair value option as a measurement attribute with respect to these classes of financial assets and liabilities on a go forward basis, contrary to the principles and objectives outlined in FAS 159. Accordingly, the entity’s purported adoption of FAS 159 is not substantive and would not be considered a proper application of FAS 159...”

“If an entity proposes to adopt the fair value option merely to achieve an accounting result that is contrary to the principles and objectives in FAS 159 (i.e., recording unrealized losses directly in retained earnings coupled with little or no intent to apply the fair value option as a measurement attribute with respect to these classes of financial assets and liabilities on a go forward basis), the auditor should reach a conclusion that the entity’s proposed accounting departs from generally accepted accounting principles.”

In view of the CAQ Alert, we would recommend that any institution that has early adopted FAS 159, under the circumstances shown above, consider meeting with their auditors to determine how an apparent departure from GAAP should be corrected, if in fact a departure is determined. Since Call Reports must be filed in accordance with GAAP, an institution may be required to adjust its books and records to comply with GAAP if an apparent departure is determined. Please contact Staff CPA Mrs. Dale Jacobs with any questions.

Educational and Informational Websites – The Federal Reserve Bank of St. Louis has a website designated for director training that focuses on topics that relate to evaluating a bank’s financial performance and managing the risks to its portfolio (credit risk, market risk, and liquidity risk). The link is <http://www.stlouisfed.org/col/director/agenda.htm>. We believe that it will be useful for new or experienced directors. In addition, if you haven’t checked out the CSBS website, please take the time to review it. Their weekly newsletter will update you on current matters and topics of interest to the state banking system. This direct link to the current newsletter is located at <http://www.csbs.org/Content/NavigationMenu/PublicRelations/CSBSExaminer/ExaminerMain.h>

[tm](#). Another link on CSBS' website is an excellent source for all federal agency guidance in one spot. This website is http://www.csbs.org/AM/Template.cfm?Section=Federal_Agency_Guidance_Database&Template=/customsource/federalagency/index.cfm&WebsiteKey=31cadfd9-b130-44b4-af2e-6603cbcc422b. You may start at CSBS' homepage, <http://www.csbs.org>, and peruse it for a host of useful information. If you have trouble accessing any of these websites, please contact Deputy Chief Examiner Kerry Morris for help.

Recent Examination Topics of Interest - At some recent examinations, OFI examiners have noticed that an institution's Premises Account may contain some assets that are no longer being used for the proper transaction of their business. In some cases, a branch has been closed and/or consolidated with another branch; however, the land and building remain in the Premises Account. Pursuant to OFI Policy # DI-01-2005, issued on March 14, 2005, only those assets that are currently being used in the proper transaction of an institution's business, including properties held for future expansion, may be carried in the Premises Account. Assets no longer used for such purposes should be moved to Other Real Estate Owned. Management is urged to reconcile the Premises Account periodically to ensure that all assets are being carried in an appropriate manner. Please contact Deputy Chief Examiner Kerry Morris with any questions.

Thank You - Following a courageous fight with cancer, Deputy Commissioner Doris Gunn passed away in the company of her husband and three children on February 28, 2007. Please accept my heartfelt thanks for the tremendous outpouring of sympathy on her behalf. We will all miss her counsel, spirit, and joie de vivre.

Closing Comments - Please do not hesitate to contact me directly with any questions regarding the contents of this update. I look forward to seeing many of you at one of the upcoming Hurricane Preparation Meetings.